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Coalbed Methane Development in the
Intermountain West (April 4-5)

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Keynote Address

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John Watts, *Keynote Address, in* COALBED METHANE DEVELOPMENT IN THE INTERMOUNTAIN WEST (Natural Res. Law Ctr., Univ. of Colo. Sch. of Law 2002).

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light the inherent risks that exist by an over dependence on foreign sources of energy and a corresponding inadequate domestic energy supply. Certainly, as a country, we can and should address this in a series of actions. We can develop domestic resources, we can conserve and use our resources more efficiently, and we can work with our international partners to develop their resources as well, to provide for an enhanced level of energy security.

I want you to know we're going to have an open door at the Department of Interior. I want to meet with you. Come in, that's what I'm there for, to serve the public. We had an administration meeting in February right before I came to Washington with the President and the Vice President, Secretary of State Colin Powell, and other members of the cabinet and sub-cabinet at the historic State Department Reception Rooms. You can imagine it was pretty awesome for this person from Montana to be there. I took away two pieces of guidance I want to share with you. President Bush said to us that "We had one Boss," and I expected him to say he was the boss, but he rightly said, "that Boss is the people." His direction to us is to focus on the people and policies that are directed at better serving the people.

KEYNOTE ADDRESS

JOHN WATTS, *Counsel, Energy and Natural Resources Committee, U.S. Senate*

I want to start just by thanking the Natural Resources Law Center and the other sponsors of the conference. I have learned a great deal this morning and yesterday. It's sort of obligatory for speakers to say this, but I really mean it. I've learned a great deal. The talks have been very informative and from a whole range of different perspectives, and I've really learned a lot. I also appreciate my conversations with you all apart from the regular proceedings.

I also want to start out by saying that it struck me that the amount of information we've learned has been really impressive. And I want to tell a story about how it hasn't always been that way with the Bureau of Land Management (BLM) and other public agencies. In my former life, as I mentioned, I was an attorney in the Department of Justice, and I tried cases involving the BLM and the public lands. At Justice, I had a colleague

The other thing the President said that I took to heart is that if, we see something working right and good in government, we should laud it and grow it, but if there's something that isn't working, that's broken, then let's fix it. That's good advice. I think that there's a lot that we have going on in government that is good, but there's always room for improvement, and that's what we hope to do in our time in the Administration.

Finally, I think that partnerships with the public are very important. That's something that the President, Secretary Norton and I want to do more of. We're proposing in the 2003 budget additional funds to support state and local government conservation projects that improve the health of the land. The Cooperative Conservation Initiative would provide \$100 million in challenge grants to landowners, conservation groups and local and state governments for conservation projects. This would help us better serve the public and breathe life into the Four C's.

I thank you for your attention.

who had a case which he loved to tell about back in the old days when BLM was first trying to figure out what environmental impact statements were and how to do EISs and the various land use plans that were being done. My colleague was assigned to defend an EIS. And he was a bit concerned because some of the previous EIS defenses hadn't fared too well in court. So he said to BLM, "I'm a little concerned, do you have any good analysis here?" They said, "Don't worry, we have a new analytical technique that absolutely confirms that the environment is fine. It's called "ocular reconnaissance." So my colleague strode into court with his "ocular reconnaissance" defense. He started to explain why this was such a great thing. The judge would have none of it, however. He cut off my colleague and said, "So you mean they just eyeball it?" Needless to say, the case did not go very well.

I am going to try to speak fairly briefly. You may have noticed that usually when people say they're going to speak very briefly, they end up talking even more about the subject, which is typically long enough to begin with. But I'm going to try not to follow that track. What I'm going to talk about is legislation, potential legislation out there right now regarding various issues regarding coalbed methane. The five areas include some of what you already heard about.

One, which Assistant Secretary Watson mentioned yesterday, is conflicts between coal development and coalbed methane development. A second is the study of the environmental impacts of coalbed methane. Third is tax credits. Fourth is hydraulic fracturing. And fifth is surface use agreements and enforcement of coalbed methane leases. One general point before I go into the details of each of these issues: Four of five topics are tied to the energy bill. Some of you may be aware that the House passed an energy bill last year, and the Senate is now debating an energy bill. Most of the possible legislation is on coalbed methane tied to the energy bill, which means that whether or not the legislation actually is enacted will depend upon whether the energy bill is enacted.

I know folks in this room have a wide range of feelings about the energy bill. What I'm going to say about the energy bill is that it's likely to pass the Senate without a provision regarding the Arctic National Wildlife Refuge in it. And at that point that it passes the Senate, it will go to conference between the Senate and the House. And that will be a difficult conference, because the House bill is very different from the Senate bill. It's the \$64,000 question or, more accurately, the multibillion dollar question: What happens then? Most possible coalbed methane legislation will require passage of this energy bill to become law. So I'm going to go through now the five topics identified as to what coalbed methane legislation is pending.

The first is this issue of conflict between coal development and coalbed methane development. This issue is most prominent in the Powder River Basin. There's also a similar conflict in the New Mexico portion of the San Juan Basin. The problem from the coal company's perspective is that the coal companies generally have junior leases and the senior leases contain the coalbed methane rights. You saw some of this in the powerpoint slides. The coal is essentially being plowed. The coal face is

moving along in a straight line, and there will be coalbed methane wells in the path of the coal mine. And because the oil and gas lessees have senior rights, the coal companies can't simply move on through venting the methane as they pass. Instead, they can be sued. And the coalbed methane lessees can get a preliminary injunction in court to require the coal companies to essentially swerve around the coalbed methane wells.

As a result, there have been some negotiations where coal companies have paid to buy out the coalbed methane lessees. Now, there are two views of what's happening here. You heard yesterday about the Supreme Court's decision in the Amoco versus the Southern Ute case, which determined that the coalbed methane was owned by the gas company, not the coal lessee. The Supreme Court envisioned that conflicts between the owners of the coal and the coalbed methane would be resolved through negotiation. And the oil and gas lessee's perspective is that's what has happened. They have conducted negotiations, and they will acknowledge they're in a good market position, but they would say that there's no problem. Essentially, everything that's happening is according to the way the Supreme Court envisioned it. The coal companies see it differently.

There was a western character, I believe his name was Black Bart, who in the 19th century would wait around, and he knew the stagecoach's path and when it was coming, and he would hold it up. And that was based on his knowledge of the schedule. The coal companies believe that they are being held up in a similar way by the owners of coalbed methane, in that the coalbed methane lessees know the schedule of when the coal is going to get to certain spots. In this view, they are buying up the coalbed methane rights and then holding up the coal companies for prices which are a lot more than the market value of the coalbed methane.

The bills pending now which are mentioned here on my outline, they're two very similar bills. One is by Senator Enzi, and the other by Representative Cubin. Both of them set up a process whereby if there is potential conflict between the resources, one of the parties will notify the other. They'll try to negotiate. If they can't agree, then they file a petition with the court, and the court will make a determination of which of the resources is of greater value. This is always going to be the coal, because for a specific unit of area, coal will

always have a greater value. The Court will then suspend the less valuable coalbed methane lease, allowing the coal company to plow on through. Then there will be an evaluation process with three experts, who will value the loss of income and consequential damages to the coalbed methane lessee. And then, very importantly, there will be a royalty credit for the coal companies so that they get reimbursed for what they had to pay the coalbed methane owners. And finally, the federal government will ensure that the State gets its portion of the royalty credit. Thus, the Federal government will lose several ways. It will lose the royalties that it would have gotten, and it also will end up paying the royalties to the State.

Those are the bills that are out there. Senator Bingaman, who I work for, has a statement on record expressing opposition to these bills as drafted. He has expressed several different concerns. First of all, this is just one example of a common problem of conflict between users of the public land. He is concerned that if there's going to be an attempt to resolve this conflict, that we use established eminent domain law; that we follow a regular process, not create some special process. Also, Senator Bingaman said he's concerned about the Federal government paying a credit and then also having to pay the state. The state shares in the benefits of coalbed methane development, so the state should also share in paying for any solution. So that's Senator's Bingaman's position on this issue. Where this legislation stands now is that we are waiting to hear back from the parties involved as to whether they can agree to this approach. So we're sort of on hold with this legislation.

The final thing I want to say about it is that I want to emphasize the point that Assistant Secretary Watson made, which is that if you responsibly develop both resources, the public benefits. You avoid venting coalbed methane gas into the atmosphere, and both energy sources are used. And the government gets its royalties from all the resources. I'm glad to hear that BLM is attempting to revise its instruction memorandum to encourage the development of both resources.

My second issue is the environmental impacts of coalbed methane development. There is a provision in the Senate version of the energy bill which would require the National Academy of Sciences to prepare a study over an 18-month period on the impacts to the surface and water resources of coalbed methane development. The

study would focus on some of the questions that we heard discussed at length this morning regarding how to dispose of the water, what the impacts are of water disposal, possible groundwater depletion issues, other surface issues and impacts, and what mitigation measures can improve or reduce those impacts. The way the bill is set up, the National Academy of Sciences will have 18 months to do this study. The results will then be publicly available and transmitted to the Secretary of the Interior, and she would then have to respond to the National Academy of Science's findings to indicate whether she agreed or disagreed with them and also whether she recommended to Congress any changes in law or policy based on the results of the study. So the idea is to do a broad study by the independent National Academy of Sciences. You then have the Secretary of the Interior responding to the study and the public also having a chance to respond. This provision is not in the House version of the energy bill, but it's possible that it will be in the final version of the energy bill following conference. That's the second issue.

The third issue is tax credits. And I'll start out by saying I'm not an expert on this issue, but I can tell you briefly what is out there regarding tax credits. There's an existing tax credit for production of wells from a nonconventional source. The amount of the tax credit is three dollars per barrel of oil or Btu equivalent. That tax credit would be modified and extended in both the Senate and House versions of the energy bill. The tax credit would include production of gas or methane gas from coalbeds. The House version of the energy bill could extend that credit from the date of enactment through January 1, 2007. So that if a well is drilled or a facility placed in service, the operator of a coalbed methane well could get this tax credit, three dollars per barrel; and in addition, earlier drilled wells could also get a tax credit for the same four-year period. The Senate finance committee marked up a similar provision with a three-year expansion of this tax credit, which is expected to be inserted into the energy bill as an amendment to the energy bill either this week or next during the remaining debate on the energy bill. So that's the basic status of the tax credit issue.

My next issue is hydraulic fracturing, and before I get into the legislation, I would like to say that I was very interested in yesterday afternoon's discussion. I like the

idea that was expressed that industry and the relevant agencies should share whatever data they have with the public, because I think that will help. And I wanted to let people who are concerned about hydraulic fracturing know that a source of information on that issue is likely to be publicly available soon, which is this EPA study. The EPA is doing a potentially multiphase study of the impacts of hydraulic fracturing to underground sources of drinking water. The EPA will shortly be completing the first phase in their study, which is a review of existing literature and on the potential contamination of underground sources of drinking water from hydraulic fracturing. The EPA has been undertaking a fairly rigorous process for this study. They received public comments on its design last year. More recently, they have prepared a draft of the study, which they submitted for a scientific peer review.

When I last heard from them about this issue, EPA was planning to release the draft study in April. Now, I don't know if they're going to make that schedule, but it should be available within the next couple of months. Public comment on these draft study results will follow, and EPA will then make a final determination after receiving the public comments. If EPA determines that there is clearly little or no harm from coalbed methane, then they will stop the study at this point. If they determine that there is a real potential for harm, then they'll continue, and they'll go out and do field studies, which could be a multi-million dollar, multiyear process. The main point is, if you're concerned about the potential impacts of hydraulic fracturing on underground sources of drinking water, then you should look for that study, because that's probably going to be the best source that is available to date.

Just from the spirit of sharing what information I have about information concerning impacts from hydraulic fracturing, there was a survey done in 1998 by the Groundwater Protection Council, which is an organization of State Oil and Gas Commissions and also State agencies responsible for protecting drinking water. And in that study, there were 13 State agencies that responded to the survey who indicated that they had coalbed methane production in their states. And of those 13 State agencies, none of them reported any verified instances where hydraulic fracturing in coalbed methane had contaminated underground sources of drinking water. That survey has been criticized as incomplete, in that it was simply an instance of what information had been report-

ed to State agencies; and that, potentially, something could have happened that wasn't reported to State agencies. EPA acknowledged the survey was done and is asking for public comment on any additional instances where drinking water has been contaminated. So EPA's current study may well close any gaps in the Groundwater Protection Council survey.

There is one other issue I would like to address. It was stated yesterday that there are hazardous constituents in hydraulic fracturing fluids, and it is true that there sometimes are chemicals such as benzene and zylene, in fracturing fluids. However, from what I have been able to gather, those constituents are generally or almost always associated with fracturing in deeper formations such as those containing oil. There are no reported cases where the very low concentration of these chemical constituents has migrated up to drinking water aquifers from the generally deeper oil or gas bearing formations. So, as far as I know, there is no evidence that these chemical constituents in fracturing fluids have contaminated drinking water sources.

I think this process of information gathering on this issue is important. What's currently in the Senate energy bill is a provision which Senator Bingham, my boss, sponsored which requires the EPA to do a study of hydraulic fracturing's potential effects on underground sources of drinking water. And the basic idea of this provision is that we should examine whether this is a problem that would require Federal regulation on top of the existing state regulation of hydraulic fracturing. And the way this provision would work is that the EPA would have 24 months to do a study. The Natural Academy of Sciences would then have nine months to review the EPA study. And then there would be a several month period for EPA to determine whether or not there was a need for regulation of hydraulic fracturing under the Safe Drinking Water Act (SDWA). During the period of the study, state programs would remain in place. And state programs, as you heard yesterday, already protect underground sources of drinking water through a variety of ways, including casing around the well bore where it goes through an underground source of drinking water. The state regulations remain in place, and for Federal regulation, the status quo would be maintained.

If there's one state that's required to regulate hydraulic fracturing under the SDWA, it's Alabama as a result of the 11th circuit decision in *Legal*

Environmental Assistance Foundation v. United States Environmental Protection Agency, 118 F.3d 1467 (1997). Alabama would still have to regulate hydraulic fracturing under the SDWA during the study. Other states are not currently required to regulate hydraulic fracturing, and they would not be required to regulate it under the Safe Drinking Water Act during the study. And the EPA would retain its emergency powers to regulate homes to drinking water that immediately threatens the public health. Even without this provision of the energy bill, states are unlikely to voluntarily regulate hydraulic fracturing under the SDWA. If a lawsuit were filed to try to force them to do so, it probably would take about 12 to 18 months to get a decision, perhaps longer, and then even if the State lost, it would probably be given – if Alabama's experience with their previous litigation is any model – another year to develop regulations. So even without this provision of the energy bill, states probably would not regulate hydraulic fracturing under the SDWA for the next two to three years, which is roughly the same amount of time as the EPA study.

I'm about to violate my comment that I was going to speak briefly. So I will now move onto surface use agreements. Surface use agreements are a difficult issue. There's currently not any legislation out there on this topic. There is, however, legislation on a related topic, which is inspection and enforcement of oil and gas leases including coalbed methane leases. The Senate energy bill currently includes an increased authorization of appropriations for the aggregate of permit processing and increased inspection and enforcement of oil and gas leases. It's likely that this provision is going to be amended to break out a separate increased authorization for inspection and enforcement in particular. There are a number of places, including the New Mexico and San Juan Basin, where the agency is currently quite deficient in the number of folks it has to do inspection and enforcement, and we want to correct this situation.

Let me say a few more words about surface use agreements. First of all, I want to thank Jill Morrison for her moving presentation of the issues facing the ranching community on split estate lands. You have to be pretty unfeeling to not sympathize with what a lot of ranchers are going through. And it's because I take the ranchers' concerns seriously that I want to be straightforward about my perception of the situation on Capitol Hill on this

issue. I don't think in the near term it's likely that any legislation will require surface use agreements. Under existing law, the Stock-Raising Homestead Act of 1916 currently gives the oil and gas lessee three options for dealing with surface users. One is to obtain their consent for surface operations. Second is to obtain a damage agreement concerning any damage of the surface use. And third, as a final choice, to post a good and sufficient bond of at least \$1,000. You would have to change this provision of law to require surface use agreements on split estate lands.

This is a difficult issue because it pits the environmental community and the ranching community against the oil and gas community, and the oil and gas industry is very strongly mobilized. I know because I've heard from them. And western senators generally want very much to support both groups—both the ranching community and the oil and gas industry. And so I think in the near term it's going to be difficult to get a major change in the law. However, that's the bad news. The good news is that you heard from Assistant Secretary Watson yesterday that she felt that it was time to reexamine this issue. And I know that my boss, Senator Bingaman, wants to improve the situation, as does Senator Baucus. And this is something that I and others are going to be working on over the next few months and longer if necessary. There was legislation that had circulated which would have encouraged surface use agreements and required BLM to develop procedures for making them work better and also require BLM to report back with suggestions and improvements. And from what I understand, the ranching community did not support this legislation because they believed it did not go far enough.

But there's a chance to address this administratively, I think, because a number of key parties believe this is an important issue. There is a chance for BLM to start working with other interested parties to make effective surface use agreements happen more often and perhaps to develop model surface use agreements to address the issues that concern the ranching community. There is a chance to work it into the process, perhaps to provide incentives for oil and gas lessees to sign surface use agreements. There's a chance, I think, for people to think creatively about this issue and for there to be some progress made.

I think I will stop with that. And just say, once again, thank you all very much for what I've learned from you, which has been a great deal over the past few days.